1. MARKET DEVELOPMENTS AND FRS COMPANIES IN 2001

Developments in Global Oil and Natural Gas Markets

The 30 major U.S. energy companies[1] reporting to the Energy Information Administration's Financial Reporting System (FRS) derive the bulk of their revenues and income from petroleum operations, including natural gas production. A majority of these companies are multinational, with 41 percent of the majors' net investment located abroad. Worldwide petroleum and natural gas market developments are of primary importance to the companies' financial performance. (For a list of these companies, see the box entitled "The FRS Companies in 2001.")

The FRS Companies in 2001

Amerada Hess Corporation	LYONDELL-CITGO Refining, L.P.
Anadarko Petroleum Corporation	Marathon Oil Corporation
Apache Corporation	Motiva Enterprises, L.L.C.
BP America, Inc.[2]	Occidental Petroleum Corporation
Burlington Resources, Inc.	Phillips Petroleum Company
ChevronTexaco Corporation	Premcor, Inc.
CITGO Petroleum Corporation	Shell Oil Company
Conoco, Inc.	Sunoco, Inc.
Devon Energy Corporation	Tesoro Petroleum Corporation
Dominion Resources, Inc.	Tosco Corporation
El Paso Corporation	Total Fina Elf Holdings USA, Inc.
EOG Resources, Inc.	Ultramar Diamond Shamrock Corporation
Equilon Enterprises, L.L.C.	Unocal Corporation
Exxon Mobil Corporation	Valero Energy Corporation
Kerr-McGee Corporation	The Williams Companies, Inc.

Demand for oil and natural gas in 2001 generally declined throughout the year. Declining energy demand reflected a sharp slowdown in global economic growth. World economic growth, as measured by the annual percent change in real Gross Domestic Product (GDP), was only 1.1 percent in 2001, down from real GDP growth of 3.9 percent in 2000.[3] In the United States, real GDP growth fell from 4.1 percent to 1.2 percent between 2000 and 2001. Nearly all regions of the world showed a similar pattern of reduced economic growth.

In the world oil market, demand was flat between 2000 and 2001 on an annual basis.[4] World oil demand in the first quarter of 2001 grew 1.2 percent compared to the first quarter of 2000, but by the fourth quarter, demand was 1 percent below that of the prior year. The decline in world oil demand was led by the United States, where first quarter oil consumption was up 3 percent but by the fourth quarter demand was 3 percent below the fourth quarter of 2000.

On the supply side, overall world oil production in 2001 was also essentially flat on an annual basis. Although members of the Organization of Petroleum Exporting Countries (OPEC), excluding Iraq, cut their oil production by an average of nearly 700 thousand barrels per day during the year, the OPEC cuts were matched by increased oil production by Russia and Mexico.

As a result of the decline in oil demand during 2001, worldwide petroleum (oil and refined products) inventories generally rose. In the United States, commercial petroleum inventories at the end of 2001 were 12 percent above prior-year levels. The growth in inventories put downward pressure on oil prices throughout the year. World oil prices (as measured by the refiner acquisition cost of imported crude oil) fell from $25 per barrel in December 2000, to $16 per barrel in December 2001. On an annual basis, world oil prices fell from $28 per barrel in 2000 to $22 per barrel in 2001.

Natural gas prices in the United States declined even more steeply during the year. At the beginning of the year, in January, a colder-than-normal winter combined with already tight supply conditions raised U.S. natural gas prices at the wellhead to a peak of $8 per thousand cubic feet. Domestic natural gas producers responded to the incentive of high prices, increasing production by over 2 percent for the year. Natural gas imports, mostly from Canada, were up 6 percent. However, U.S. natural gas consumption, which was up 3 percent in the first quarter of 2001 compared with the first quarter of 2000, began to fall after the end of the 2000-to-2001 heating season. In the fourth quarter of 2001, U.S. natural gas consumption was 14 percent less than in the final quarter of 2000. The sharp drop in demand was mainly due to milder temperatures compared to the fourth quarter of 2000, although industrial demand was down as well.

The excess supply of natural gas relative to demand served to rebuild inventories, which were at unusually low levels at the beginning of 2001. The sharp upswing in natural gas storage levels had a depressing effect on natural gas prices. By December, the U.S. wellhead price had fallen to $2.38 per thousand cubic feet. Nevertheless, on an annual basis, the wellhead price was $4.12 per thousand cubic feet in 2001, $0.43 higher than in 2000, equivalent to $2.40 per barrel of oil equivalent. Outside the United States, natural gas prices were also higher, particularly in Europe. The FRS companies' average natural gas price in their foreign upstream (i.e., oil and gas production) operations was $0.32 higher.

In the FRS companies' upstream operations, lower oil prices outweighed the effects of higher natural gas prices and the companies' increased oil and gas production, leading to a decline in worldwide oil and gas revenues and income.

Downstream operations (petroleum refining, marketing, and transport) of the FRS companies fared better in 2001 than upstream operations, posting large gains in income and in rates of return to refining and marketing investments. Most of the gains were made in the first half of 2001. Overall U.S. petroleum demand was up 2 percent in the first half of 2001 compared with demand in the first half of 2000. The growth in first-half demand was led by heating oil (up 9 percent) and jet fuel (up 3 percent). Petroleum prices were generally higher in the first half as well, especially motor gasoline prices. Although gasoline demand was up only 1 percent, gasoline prices spiked in April and May in some areas of the country. The margin between product prices received by refiners and crude oil input costs hit a record level (at least since 1983 when EIA first collected these data) in the second quarter of 2001 of about $16 per barrel. Based on financial results for the first half of 2001, it appeared that U.S. refiners might be on their way to a record year for income and profitability.

The market for petroleum products began to turn at mid-year. In the third quarter of 2001, overall demand for petroleum products in the United States was down 2 percent compared with the prior year.

The fall in demand reflected a downturn in economic activity and the initial impacts of the attacks of September 11. Domestic demand for petroleum products, apart from gasoline, continued to deteriorate into the fourth quarter of 2001. Jet fuel was especially hard hit as fourth-quarter demand was down 15 percent compared with the prior year. By year's end, the good times had faded for U.S. refiners: fourth-quarter margins were only half of their second-quarter values. Nevertheless, for the year as a whole, the FRS companies' downstream income in 2001 was above that of 2000, both in the United States and abroad, on the strength of market developments in the first half of the year.

Chemical manufacturing is a business that is affected by both energy and overall market developments. Ten FRS companies had chemical businesses in 2001. Chemical earnings were hurt by unusually high natural gas prices early in 2001, as natural gas is a key component of many feedstocks used in the manufacture of chemicals. Reduced economic growth in most of the industrialized countries and chronic worldwide overcapacity in the chemical industry put downward pressures on prices throughout the year. The result was the lowest rate of return to the FRS companies' chemical operations in 20 years.

Changes in the FRS Group in 2001

Mergers and Acquisitions

In 2001, four FRS companies were acquired by other FRS companies. On January 29, 2001, El Paso and Coastal merged in a transaction valued at $24.0 billion. El Paso was the successor company. On September 17, 2001, Phillips Petroleum acquired Tosco in a transaction valued at $9.4 billion. On October 9, 2001, Chevron and Texaco merged into ChevronTexaco in a transaction valued at $39.3 billion. On December 31, 2001, Valero Energy merged with Ultramar Diamond Shamrock in a transaction valued at $6.1 billion. Valero Energy was the successor company. In comparison with Phillips Petroleum and Valero Energy, Tosco and Ultramar Diamond Shamrock continued to report to the FRS on a stand-alone basis in 2001.

Exits

Enron Corporation, an FRS respondent since 1992, filed for bankruptcy protection under Chapter 11 on December 2, 2001. The U.S. Securities and Exchange Commission did not require Enron to file a Form 10-K or an audited financial statement for the 2001 reporting year. Lacking either a Form 10-K or audited financial statements for 2001, Enron was not required to file Form EIA-28 (the Financial Reporting System) for 2001.

The FRS Companies' Importance in the U.S. Economy

For the reporting year 2001, 30 major energy companies reported their financial and operating data to the EIA Financial Reporting System (FRS) on Form EIA-28.[5] These companies (referred to as the FRS companies in this report) occupy a significant position in the U.S.[6] economy. In 2001, operating revenues of the FRS companies totaled $806 billion, which is equal to 11 percent of the $7.4 trillion in revenues of the Fortune 500 largest U.S. corporations.[7]

The reporting companies engage in a wide range of business activities, but their most important activities are in the energy sector. About 94 percent, or $777 billion, of allocated operating revenues were derived from energy sales. Nearly all of these revenues were derived from the companies' core petroleum operations (which includes natural gas) (Figure 1). (For the purposes of this report, the petroleum line of business includes natural gas.[8])

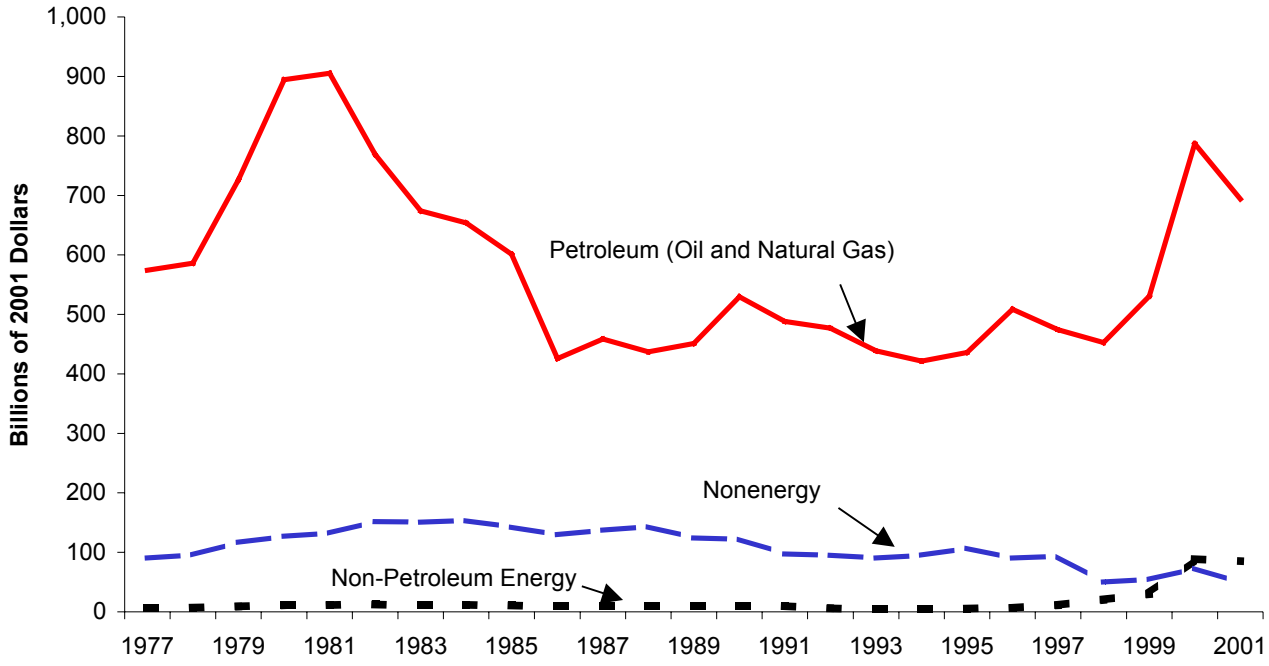
In 2001, the FRS companies accounted for 46 percent of total U.S. oil (crude oil and natural gas liquids (NGL)) production, 46 percent of natural gas production, and 92 percent of U.S. refining capacity (Figure 2). The bulk of the FRS companies' assets and new investments were devoted to sustaining various aspects of petroleum production, processing, transportation, and marketing.

Energy production other than oil and natural gas is a relatively small, but growing, part of the FRS companies' operations. During 2001, the combined operating revenues of the coal and other energy operations of the FRS companies totaled $85 billion, or 10 percent of allocated revenues. Increased activity in electricity more than offset the continued decline in coal activity by the FRS companies in 2001. In particular the FRS companies accounted for 29 percent of U.S. coal production in 1991, 15 percent in 1997, 7 percent in 1998, and 3 percent in 2001, with these declines largely being due to the relative lack of profitability attributable to this line of business. Meanwhile, FRS other energy (exclusive of coal), which is chiefly composed of electricity operations, increased from 0.4 percent of allocated revenues in 1996 to 10.1 percent in 2001.

During the 1980's, the FRS companies were major producers of domestic uranium. However, no FRS company has produced uranium oxide since 1991.

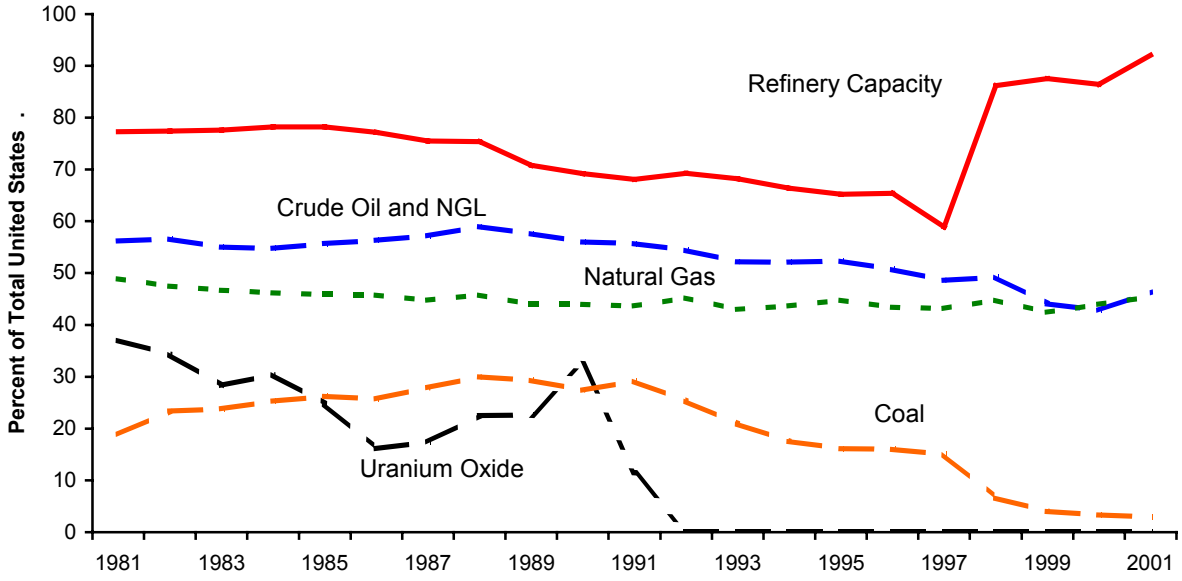
Nonenergy businesses, mainly chemicals, accounted for about 6 percent, or $48 billion, of the FRS companies' allocated revenues in 2001.

Figure 1. Operating Revenues by Line of Business for FRS Companies, 1977-2001



Source: Energy Information Administration, Form EIA-28 (Financial Reporting System)

Figure 2. Shares of U.S. Energy Production and Refinery Capacity for FRS Companies, 1981-2001



Note: The FRS companies last produced uranium in 1991.
Sources: Table B1; Total industry uranium oxide production is from Energy Information Administration, Uranium Industry Annual 1992, DOE/EIA-0478(92) (Washington, DC, October 1993).

Endnotes

[1] The U.S.-based energy companies that respond to the Financial Reporting System (FRS) Form EIA-28 are considered to be U.S. majors by the Energy Information Administration (see P.L. 95-91, Sec. 205 (h)). Per the requirements of that statue, the Administrator of the Energy Information Administration designates "major energy-producing companies" and selects them as respondents to the FRS. Currently, the Administrator uses the following selection criteria: at least 1 percent of U.S. crude oil or natural gas liquids reserves or production, or at least 1 percent of U.S. natural gas reserves or production, or at least 1 percent of U.S. crude oil distillation capacity. The companies that reported to the FRS for the years 1974 through 2001 are listed in Appendix A, Table A1 (available on the EIA website at http://www.eia.doe.gov/emeu/pefpro/tabal.html). Three of the FRS companies are owned by foreign companies: BP America—owned by BP plc; Total Fina Elf Holdings USA—owned by TotalFinaElf; and Shell Oil—owned by Royal Dutch/Shell.

[2] BP America, the U.S. subsidiary of BP plc of the United Kingdom, is the FRS respondent.

[3] Real GDP growth rates are from Global Insight, *World Overview* (September 2002).

[4] In this chapter, energy data were obtained from Energy Information Administration, *Monthly Energy Review*, DOE/EIA-0035(2002/09) (Washington, DC, September 2002).

[5] Aggregate time series data from Form EIA-28 for 1977 through 2000 and previous editions of this report can be obtained from the EIA (see http://www.eia.doe.gov/emeu/finance/page2.html).

[6] For the purposes of this report, the term "United States" typically includes the 50 states, the District of Columbia, Puerto Rico, and the U.S. Virgin Islands.

[7] The Fortune 500 is a list of the 500 largest U.S. corporations, ranked by revenues, published annually by *Fortune* magazine (see http://www.fortune.com/indexw.jhtml?channel=list.jhtml&list_frag=list_3column_fortune500_list.jhtml&list=15&_requestid=11108/).

[8] Generally accepted accounting principles (GAAP) for the United States do not require that energy companies separately account for costs of oil production and natural gas production in company financial records. Various exploration and development costs cannot easily or separately be assigned to either oil production or natural gas production.